

SEÐLABANKI ÍSLANDS

Macroprudential policy

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* Views expressed do not reflect the views of other members of the monetary policy committee of the Central Bank of Iceland

Macroprudential policy

Main objective:

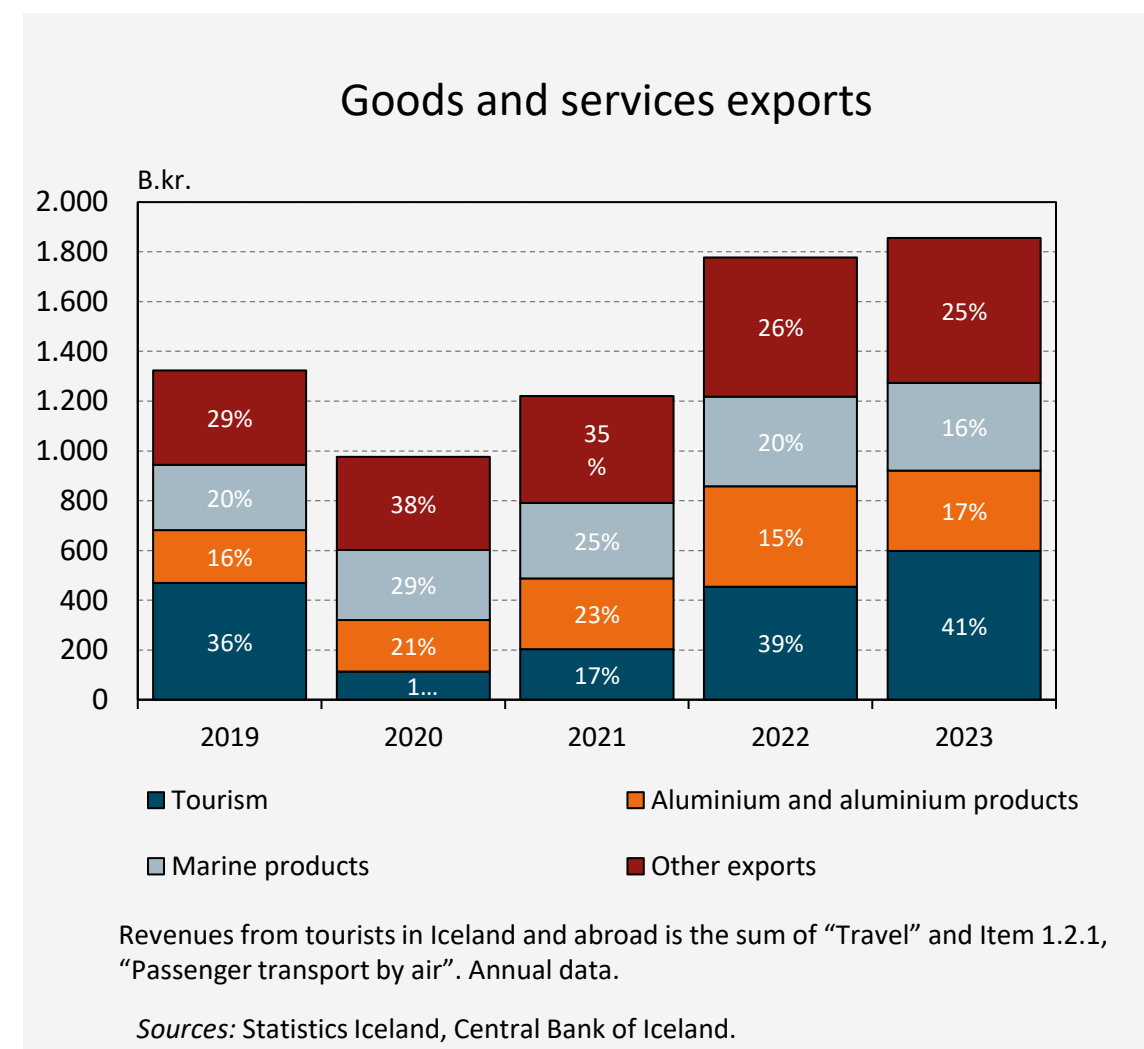
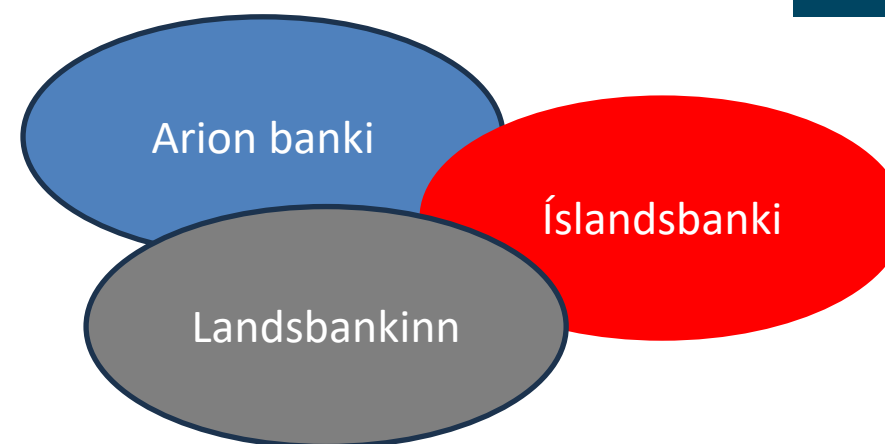
- Mitigate *systemic risk* in the financial sector
 - the risk of widespread disruption to provision of financial services → with negative consequences for the real economy
 - *Preventative* (not to manage financial crises)
- Broad objective → cannot be defined numerically

Need to identify potential ***market failures*** and ***vulnerabilities***

- Macroprudential tools designed and implemented to address those risks
 - Current macropru measures in large part informed by lessons from the 2008 global financial crisis

Iceland

- Very small open economy
- Concentrated banking sector
 - Three domestic-systemically important banks
 - Comprise over 90% of the banking sector
- Shallow financial markets
- Limited economic diversification
 - Income base dependent on small number of sectors → which are vulnerable to range of shocks
- Seismic/volcanic activity
- Important that the banking sector has enough resilience to handle unpredictable shocks



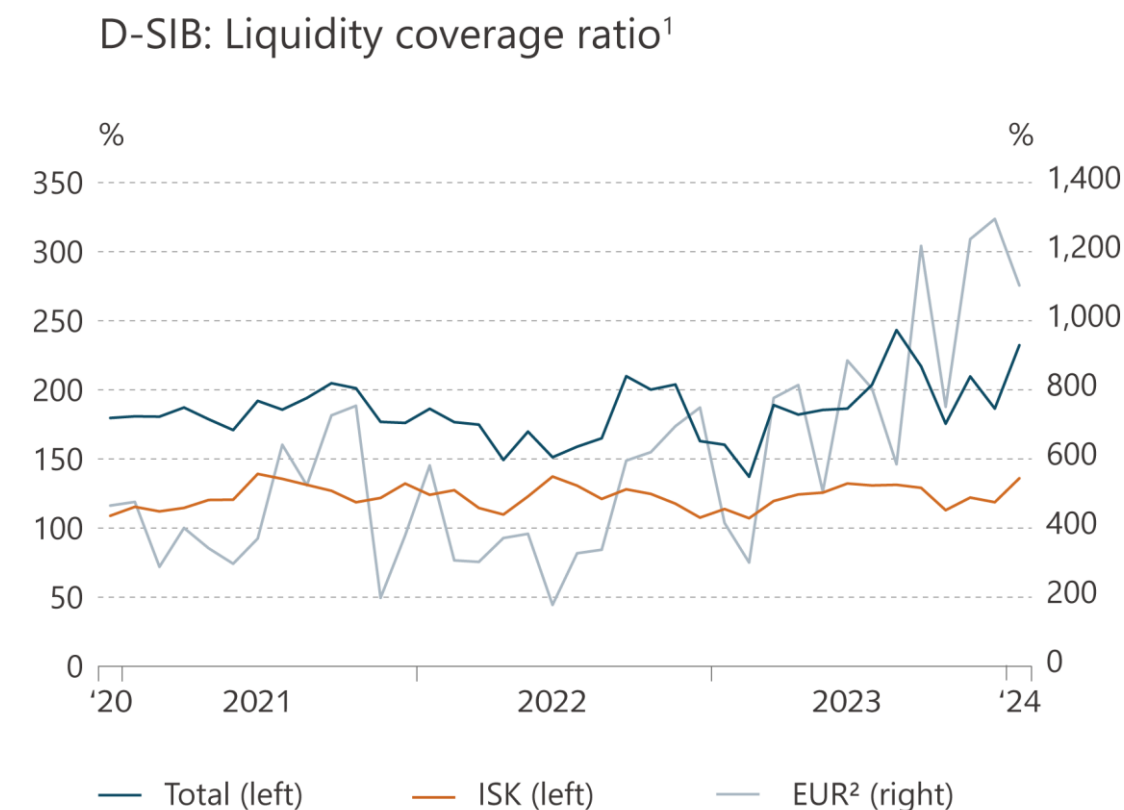
Banking sector resilience

- Building and releasing buffers

	Current capital buffers: D-SIB
Systemic risk buffer (SyRB)	3%
Capital buffer for domestic systemically important banks (O-SII)	2%
Countercyclical capital buffer (CCyB)	2.5%
Capital conservation buffer (CCoB)	2.5%
Combined buffer requirement	10%

Source: Central Bank of Iceland

- Ensuring ample liquidity coverage



1. Consolidated figures. 2. Rules no. 1520/2022 took effect on 1 January 2023, they stipulate a 80% liquidity ratio in euros if euro-denominated liabilities constitute 10% or more of a credit institution's total liabilities.

Source: Central Bank of Iceland.

“Financial institutions remain well capitalised, liquid and profitable, and well provisioned against expected future losses”

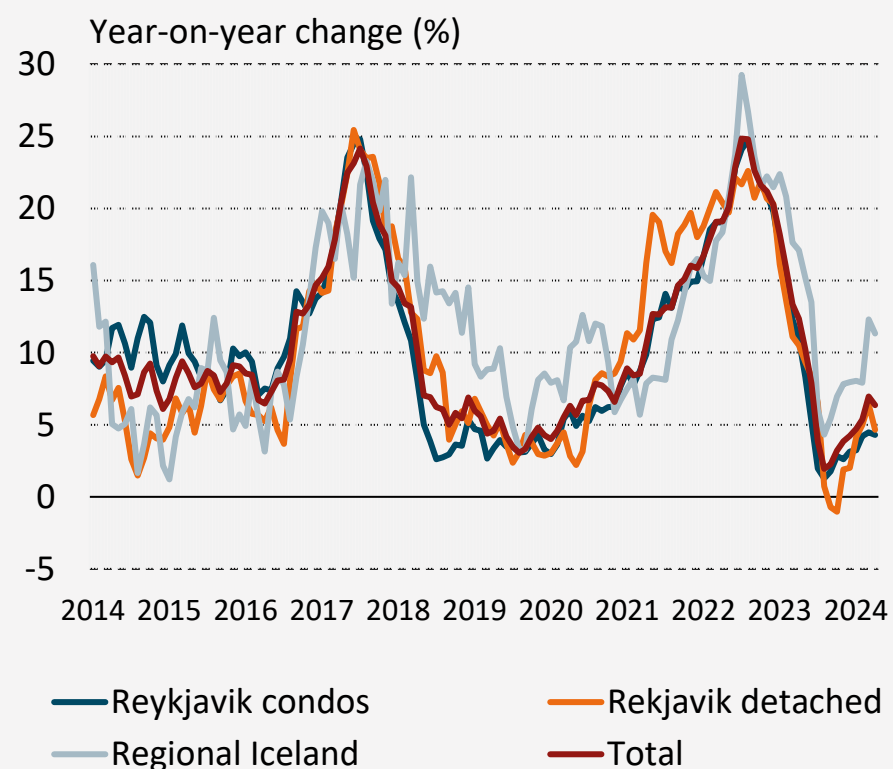
From IMF's Iceland: Staff Concluding Statement of the 2024 Article IV Mission, 22 May, 2024

Iceland

- Volatile housing market
- Large influx of working age population

House prices

January 2014 - April 2024



Source: Statistics Iceland.

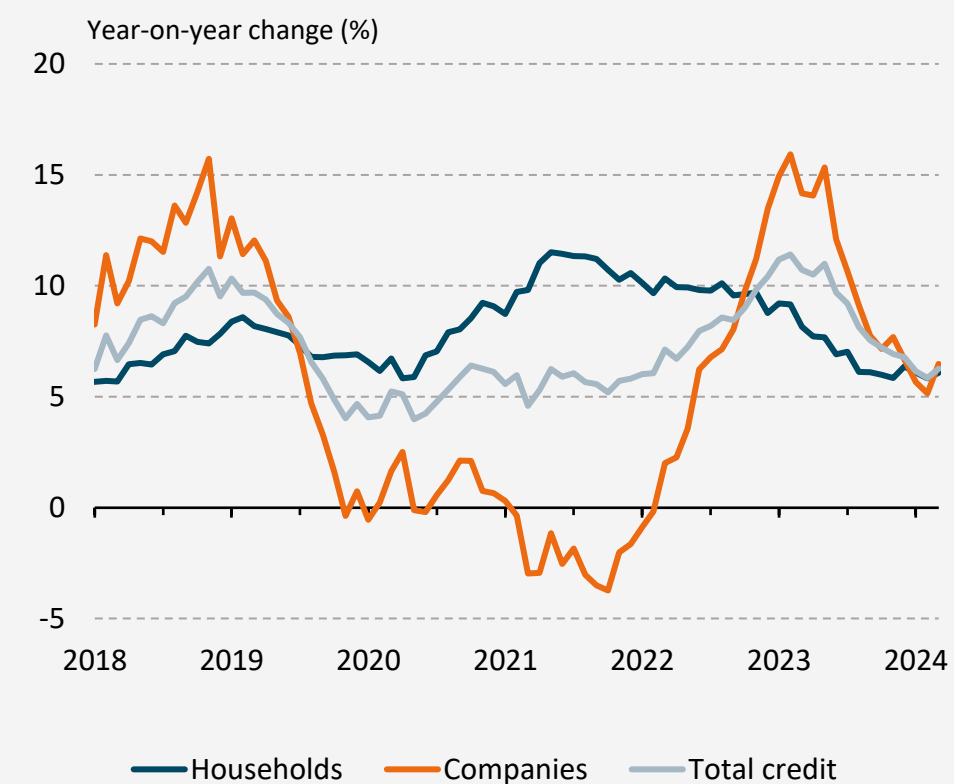
Working age population¹

January 2019 - March 2024



Credit system lending²

January 2018 - March 2024



Source: Central Bank of Iceland.

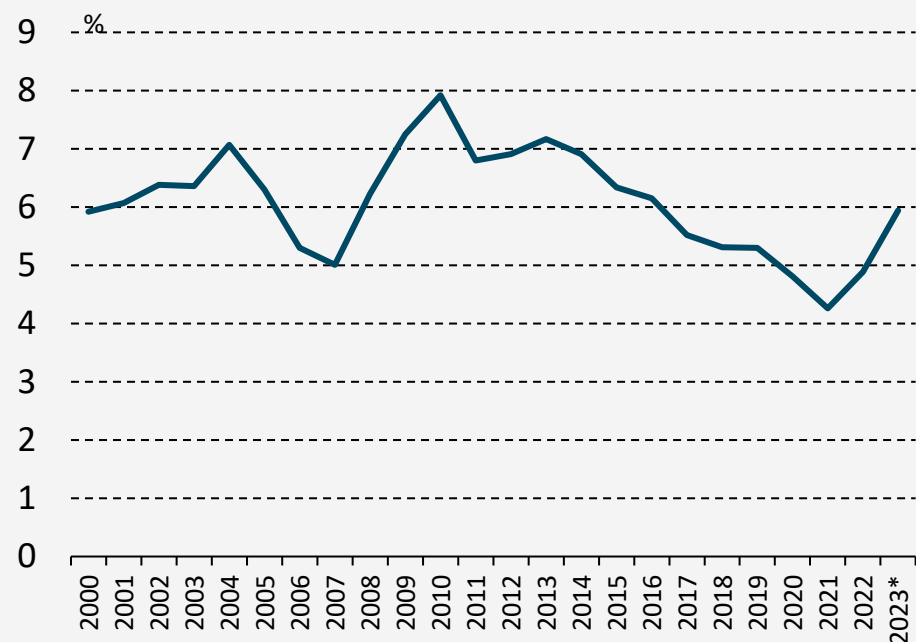
¹ 3-month moving average

² Credit stock adjusted for reclassification and effect of Government debt relief measures. Excluding loans to deposit institutions, failed financial institutions, and the Government. Companies include non-financial companies and non-profit institutions serving households.

LTV-ratio and DSTI-ratio restrictions

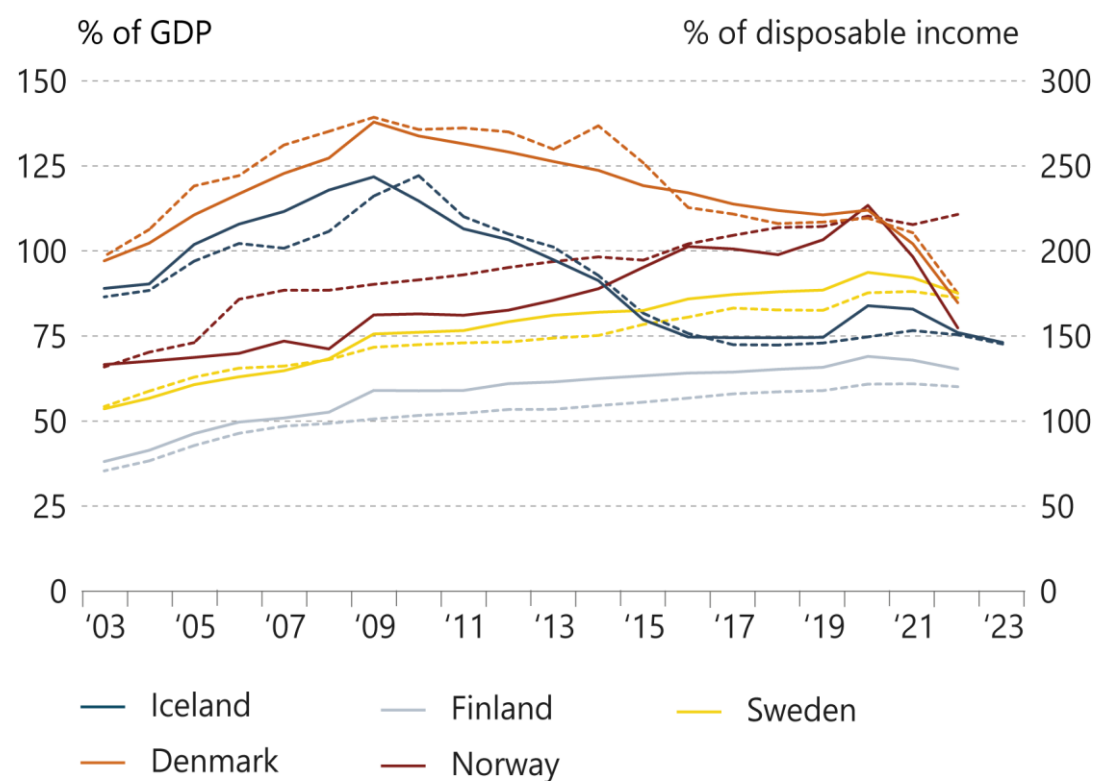
Restrictions	General	First-time buyers (and Grindavik residents)
Maximum LTV ratio	80% of the market value of the underlying property Since 30/06/2021	85% of the market value of the underlying property Since 15/06/2022
Maximum DSTI ratio	35% of disposable income Since 29/09/2021	40% of disposable income Since 29/09/2021

Mortgage interest expense as a share of households' disposable income



1. Household mortgage interest expense as a share of disposable income. Disposable income is income net of taxes. The 2023 value is a Central Bank estimate derived from data on developments in disposable income taken from the Bank's QMM database and interest payment data from the credit register. Sources: Statistics Iceland,

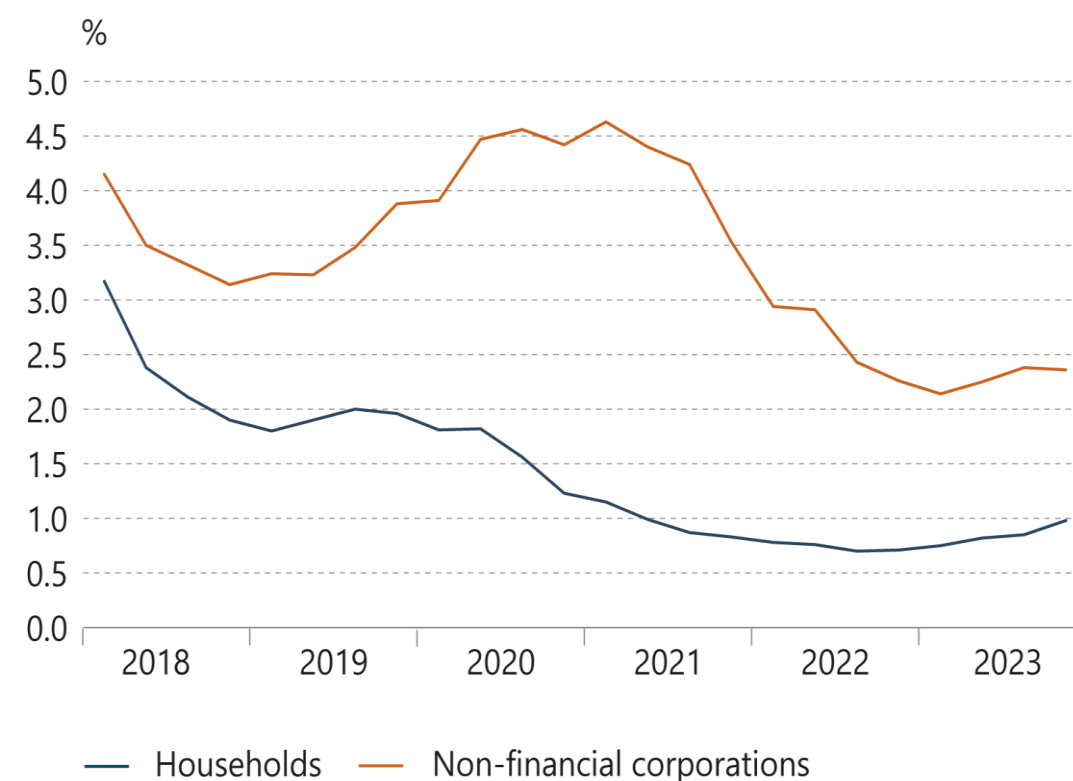
Household debt ratios in the Nordic countries¹



1. Solid lines show household debt-to-GDP ratios on the left axis while dashed lines show debt-to-disposable income ratios on the right axis. Disposable income is income net of taxes.

Sources: Bank for International Settlements, Eurostat, Statistics Iceland, Central Bank of Iceland.

D-SIBs: Non-performing loans ratio¹

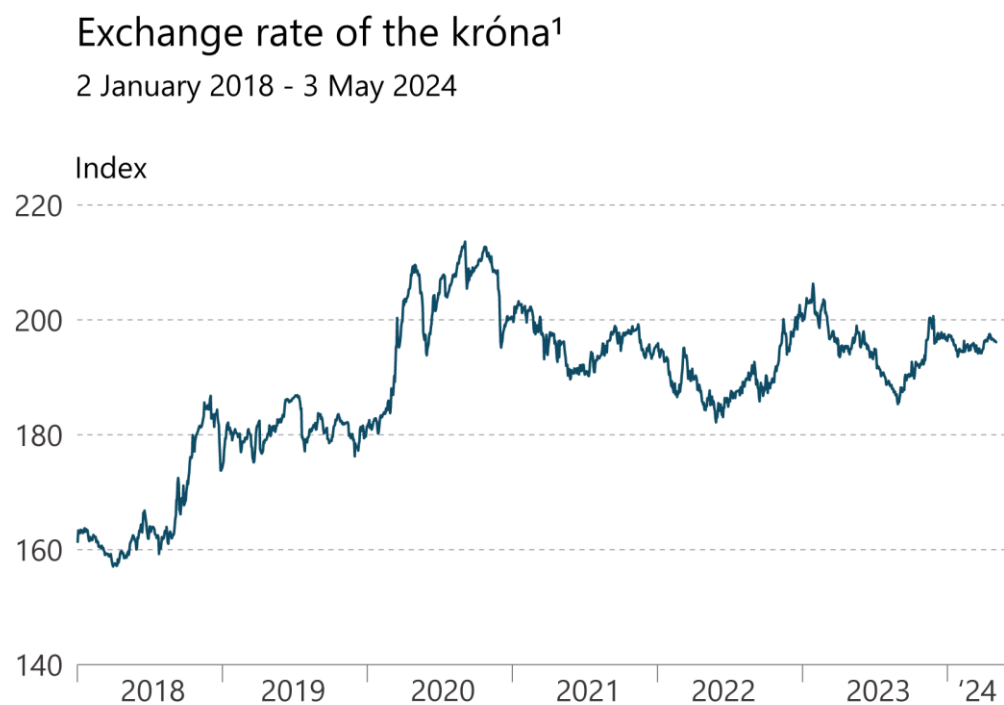


1. NPL ratio calculated according to EBA standards.

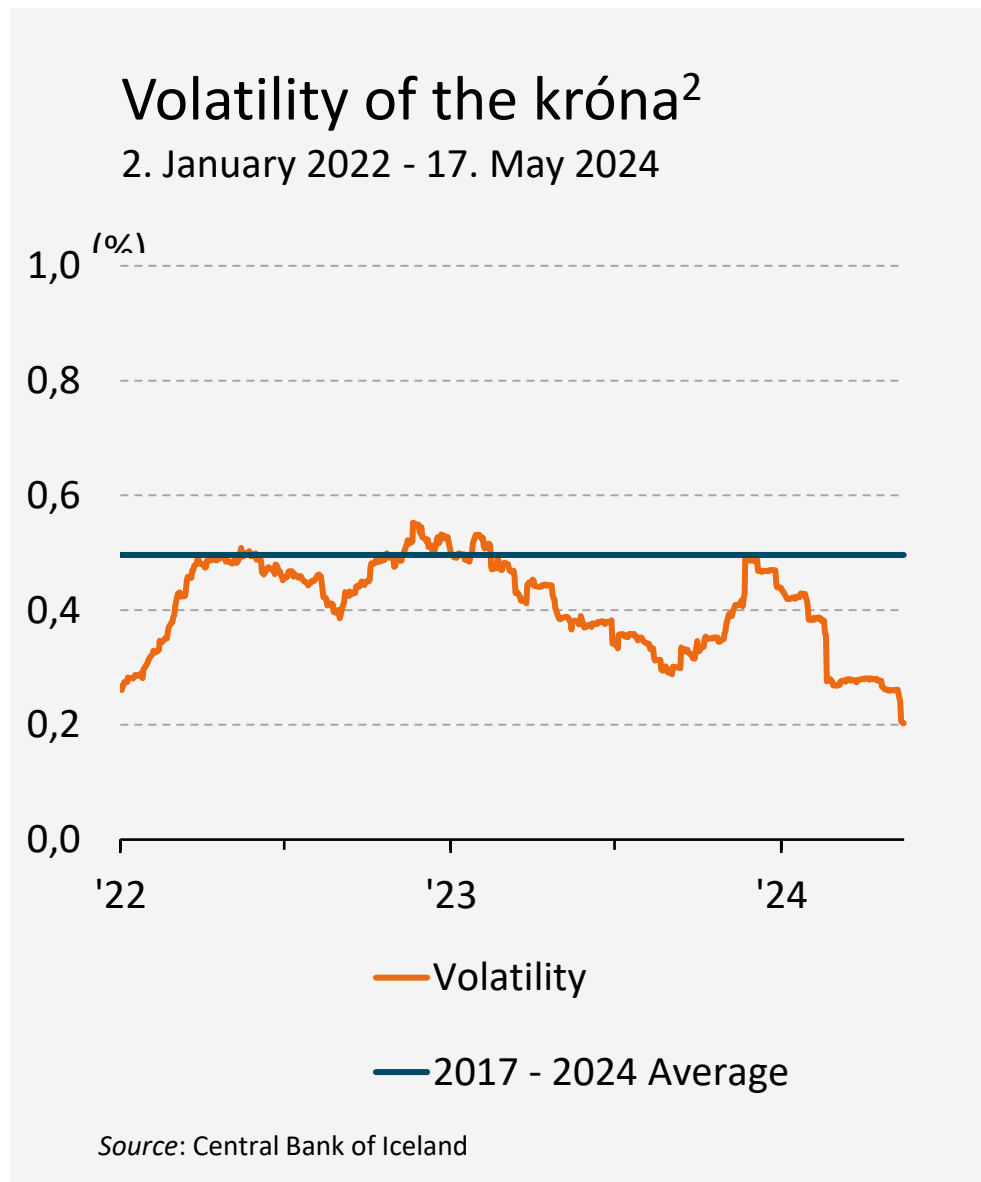
Source: Central Bank of Iceland.

Foreign exchange

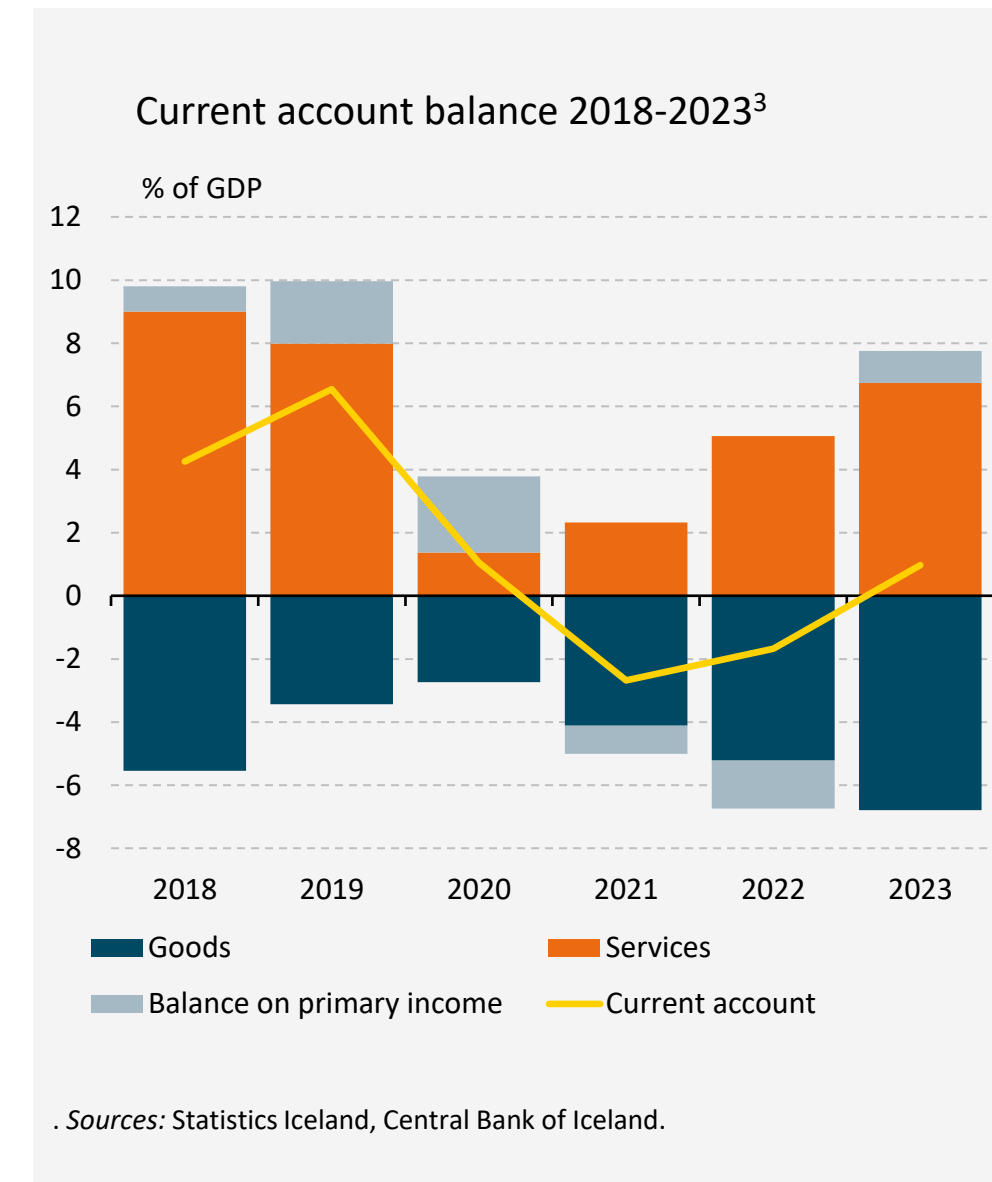
- Being a small open economy → sensitive to fluctuations in the exchange rate



1. Price of foreign currency in krónur. Narrow trade index.
Source: Central Bank of Iceland.



Source: Central Bank of Iceland



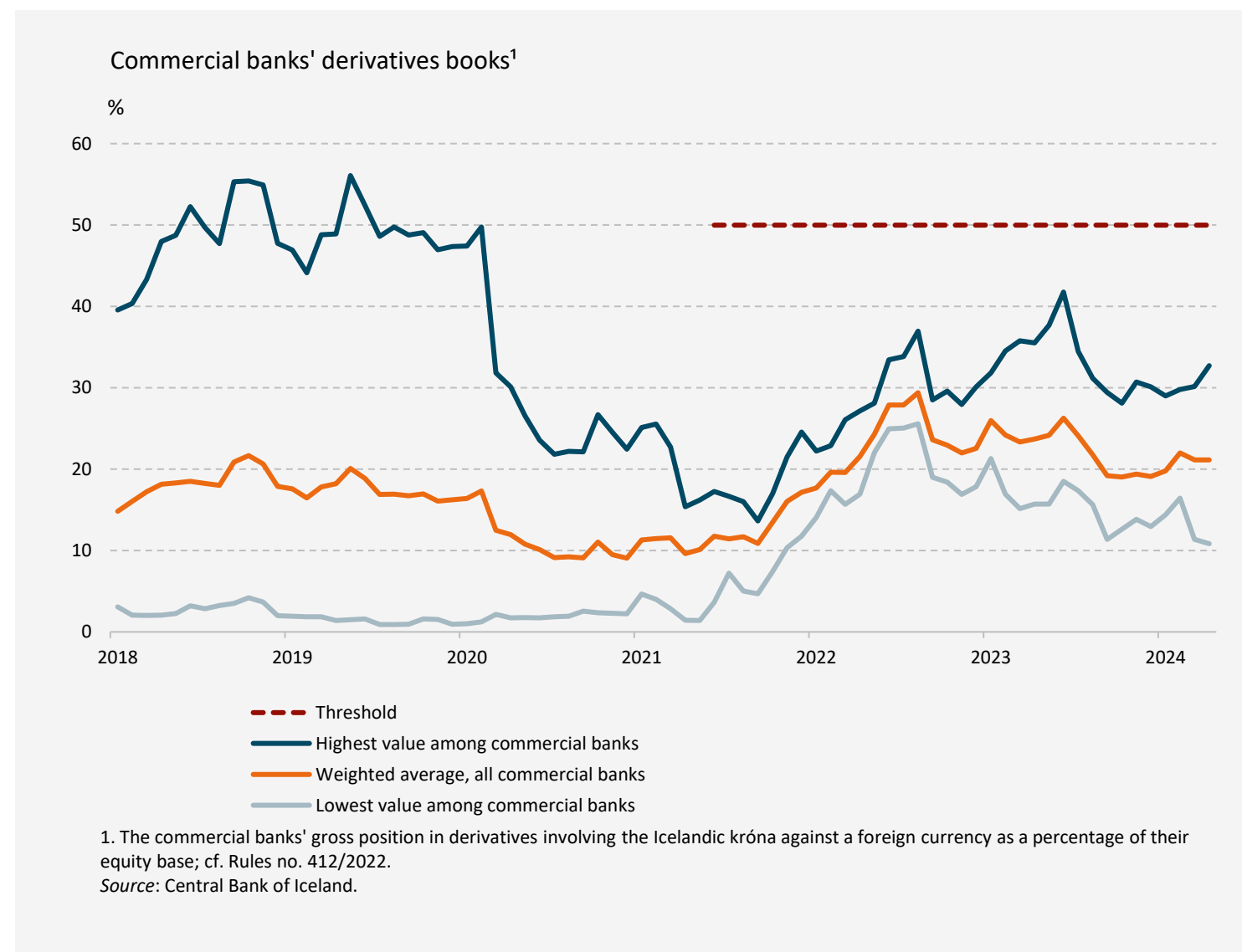
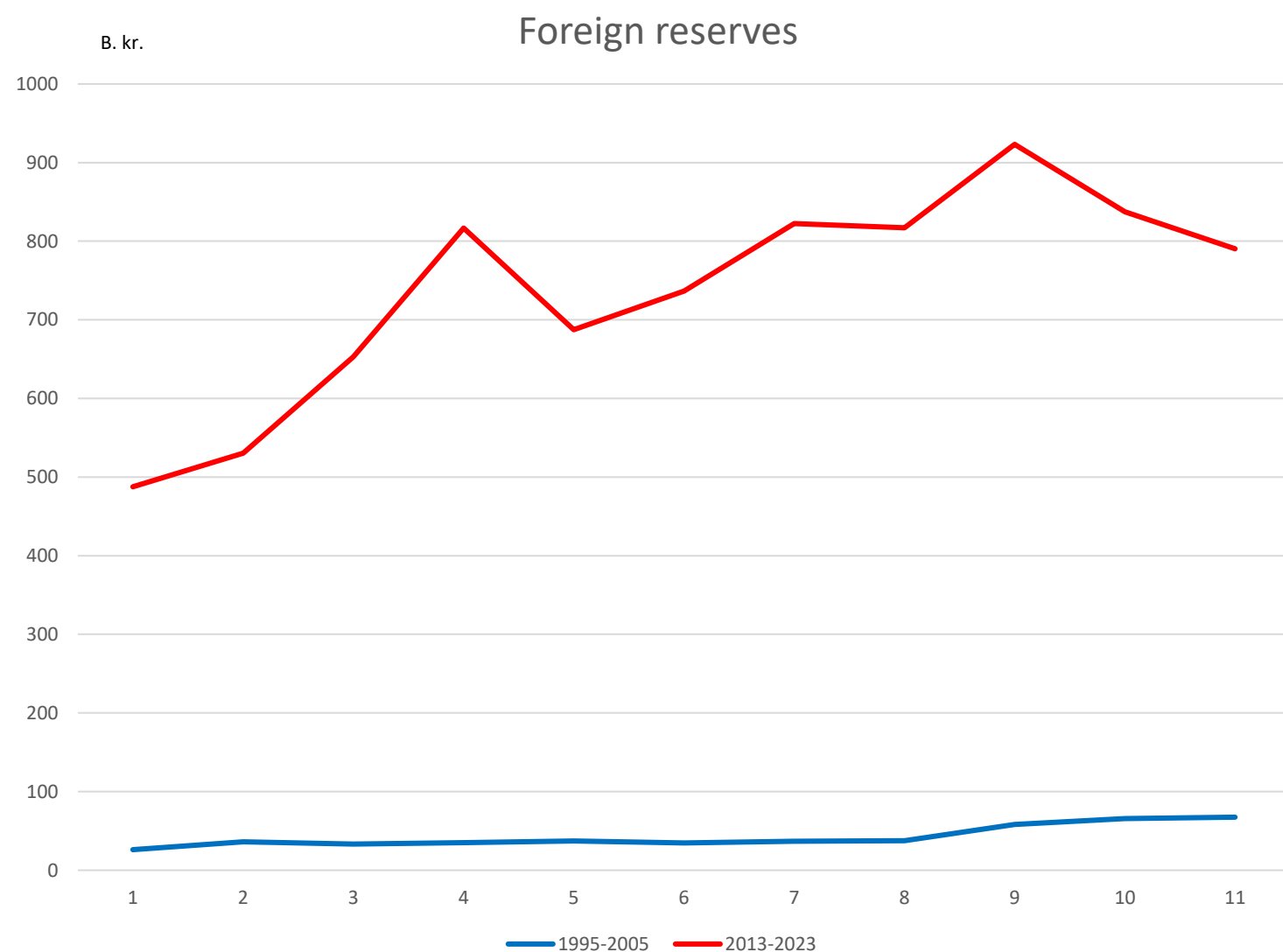
Source: Statistics Iceland, Central Bank of Iceland.

2. Volatility is measured by standard deviation of daily changes in past 3 months

3. Current account excluding the effects of the failed financial institutions in 2015. Balance on secondary income included in the balance on primary income

Foreign exchange

- No more capital flow restrictions
- Increase in size of international reserves (from approx. 5% of GDP mid-90s to current level of 20%)
- Limits imposed on domestic commercial banks' derivatives transactions



Changes to unremunerated reserve requirement ratio

Central bank of Iceland balance sheet:

- **Assets:** international reserves
 - Size of balance sheet increases in line with amount of international reserves
- **Liabilities:** reserves held by Icelandic banks
 - Current central bank key rate: 9.25%
- Interest on liabilities > interest received on assets

Effective date	Reserve requirement ratio, unremunerated
21/06/2023	2%
21/04/2024	3%

- Unremunerated reserve requirement ratio now at 3%
- Banks responded by lowering the interest rate offered on current and savings accounts

	Arion banki	Íslandsbanki	Landsbankinn
Current accounts	-0.85	-0.10	-0.10
Savings accounts	-0.10	-0.10	-0.10
Effective date	24/04/2024	22/04/2024	01/05/2024

Potential future financial stability risks

- Cyber threats
- Cryptocurrency initiatives
- Central bank digital currency (CBDC)
- Geopolitical considerations
- Divergence of monetary policy across countries

Monetary policy – financial stability interaction:

- Rising debt-servicing costs
- Shrinking central bank balance sheets → less liquidity
- Risks from the new world of higher interest rates and larger central bank balance sheets than previously experienced?